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HEADLINE: A TIF Over Building Funds; Developers, City Council Spar Over New Subsidies

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BODY:

Real estate developer Herbert Miller has just about everything lined up for his new $ 180 million Gallery Place project next to the MCI Center. A movie theater chain wants to open 21 screens. The national clothing stores are interested. The market for the apartments is hot. The architects have done their sketches.

But one not-so-small detail is missing: Miller wants $ 44 million from the District government, and he wants it soon.

Miller is among the developers lining up for a new D.C. program called tax increment financing, or TIF. After more than a year of delays, several developers will start getting economic incentive checks from the District government soon. Over time, the total offered in what Mayor Anthony Williams calls "a new and powerful tool [in the] arsenal of economic development programs" could mount to as much as $ 300 million.

TIFs, which have been used in jurisdictions around the country for decades, are considered by their backers one of the best economic development tools available to local governments. But others question how well they work. And in D.C., with so much money at stake, the program has already become embroiled in politics.

Under TIF, the D.C. government sells bonds backed by a development's future taxes, with the bond money going to help pay the developer's construction costs. Unlike economic development incentives available through the city's well-established revenue bond program, which provides low-cost financing to businesses locating or expanding in the city, this is not a loan; the developer doesn't have to pay anything back. The development's taxes, which would be paid in any case, are used to pay back the principle and interest on the bonds.

Miller's Gallery Place is one of three big projects that have applied for money to cover about a quarter of their construction costs. The other two are the Mandarin Hotel, proposed for the Portals complex in Southwest, and the expansion of the Washington Renaissance Hotel downtown into a convention headquarters hotel.

In a world where states and cities routinely bid against each other to attract employers and other economic engines, TIF is a lure that's particularly attractive for a city still struggling to emerge from fiscal chaos. It doesn't require raising tax rates, spending scarce existing tax money or accounting for these subsidies in each year's congressionally reviewed budget.

Miller argues that TIF is the best way to build non-office projects like his, which can be less profitable than offices. "If they had done it 10 years ago they would have had Pentagon City downtown," he said.

And it's painless for taxpayers, he said. "It's only using funding that would not be there if the project was not there."

But TIFs aren't always painless, said Richard F. Dye, a professor of economics at Lake Forest College in Illinois. In many places he has studied, TIF money has gone to projects or neighborhoods that might have been developed anyway, or to development that simply would have gone in nearby.

"This is not free money," Dye said. "There are opportunity costs. You're diverting money from some other place. You're giving subsidies where development would have occurred otherwise."

While TIF is new in the District, it is widely used in some parts of the country, particularly California, where it gets around the tax hike restrictions of Proposition 13. About 500 such bonds totaling some $ 4 billion are issued annually, according to Jeffrey M. Scruggs, managing director of PaineWebber Inc.

The technique has spread in the last decade because it reduces the pressure on cities' general funds and because it's seen as a type of user tax, Scruggs told a recent meeting of local government finance officials here.

TIF money helps pay for all sorts of things--mundane residential roads or flashy mega-projects such as Minnesota's Mall of America. Chicago alone has 72 TIF projects.

Maryland and Virginia have allowed TIFs for several years, but there is only one in operation in the two states. That helped pay for a Toys R Us warehouse in Maryland's Frederick County. Keenan Rice, a TIF consultant with the firm of MBIA MuniFinancial, said Anne Arundel County is working on the next two Maryland TIFs--a $ 28 million bond for the proposed Arundel Mills mall, and a $ 14 million issue for an office park near the Baltimore-Washington Parkway. Virginia has no TIFs but some are in the works, Rice said.

In the District, the program has become political even before the first dollar is approved. Last year, the city council established the program, saying that by 2003 as much as $ 300 million in TIF bonds could be issued. Each application needs approvals from the city's chief financial officer, the mayor, the city council and the control board before it can be sold to investors.

Developers anxious to get their share complain that the city is moving too slowly and conservatively. City officials concede the process has been slow, partly for personnel reasons, but say they are taking the time necessary to protect the city's interests.

Valerie Holt, the city's chief financial officer, has turned down one application, developer Giuseppe Cecchi's request for $ 25 million to help expand his Washington Renaissance Hotel at 9th and K streets NW into a big convention headquarters hotel.

Holt's office says the proposal as structured now is too risky for the city, largely because analysts say it may not produce enough extra tax to pay back the bonds and provide a cushion. City council members led by Jack Evans (D-Ward 2) have tried to jump in and pass a new law to give Cecchi his approval without the CFO's backing. That's prompted charges of favoritism from labor and community activists who point out that developers, including those who have applied for TIF money, were among the biggest contributors to Evans's failed mayoral campaign.

Evans held a 5 1/2-hour hearing last week, where Cecchi's backers talked about how a convention headquarters hotel is an economic necessity that won't get built without the TIF money. Cecchi said if he doesn't get the money soon he will instead build an office tower on the lot.

"I do not believe I am here asking a favor," he said. "I believe I am offering an opportunity."

Holt and her staff conceded the TIF review process has been slow, largely because of personnel changes: When Anthony Williams stepped down as CFO last year to run for mayor, the office was empty until Holt took over in May. At a lower level, the staff member in charge of TIFs has changed several times.

The two sides ended the hearing with a promise to meet again.

The wrangling over Cecchi's proposal highlights touched on two major areas of TIF concern: development priorities and fiscal soundness.

Although providing TIF money seems relatively painless from a government point of view--voters don't pay any extra tax--it is still public money.

The most common test of TIF purpose is the "but for" test--the public goal would not be accomplished "but for," or without, TIF funds. That's the argument Cecchi makes--that no major convention hotel can be developed without subsidy because of the great cost of extensive public areas and the like. Evans and his council colleague, Charlene Drew Jarvis (D-Ward 4), say that having such a hotel will help guarantee the success of the city's new convention center, under construction a few blocks away.

Not all their colleagues agree. "What a TIF is about in a sense is one developer gets a tax break, so they have to be something extraordinary, they can't be, 'Oh, I like this project,' " said Phil Mendelson (D-At-Large), who said he has doubts about Cecchi's TIF.

In contrast, he said, the Mandarin site at the Portals "hasn't been developable for 20 years. . . . These are extraordinary circumstances."

Another concern about TIF bonds is the financial soundness of each offering.

The proposed bonds have characteristics investors consider risky: They are tied to single projects and the District does not itself guarantee repayment.

In the view of Standard & Poor's, the bond rating agency, TIF bonds that draw on just one project rather than a whole neighborhood may face "insurmountable barriers to receiving investment-grade ratings except under unusual circumstances."

Those working on the District's TIF program say they aren't counting on investment-grade ratings. Still, at the hearing, Holt argued that if the city brings TIF bonds to market that aren't attractive to investors, "the TIF program would be jeopardized."

"While the council can legislate the issuance of TIF bonds, that legislation does not sell the bonds," she said.

"While the District's full faith and credit does not secure the bonds, the District may be viewed by bondholders as having a moral obligation" to repay, she added.

That's a situation where some cities would bail out a developer, while others would allow the bond to default. Neither is an attractive option, Holt said.

"If the District did allow outstanding bonds to default, there's a reality to that," she said. "Our ability to sell TIF bonds subsequent to that would be zero."

Funding Requests

Projects that have asked the District for tax increment financing:

Renaissance Hotel expansion

Project: Seventh and I streets NW, northwest corner (expansion of existing hotel).

Finances: $ 104 million project requires $ 33 million TIF bond to cover $ 25 million funding gap.

Status: Chief financial officer refused precertification.

Gallery Place

Project: Seventh and H streets NW, southeast corner (apartment, retail, movie and parking complex).

Finances: $ 180 million project; requires $ 65 million TIF bond to cover $ 44 million funding gap.

Status: Precertified by chief financial officer; on schedule for further approvals this year.

Mandarin Hotel

Project: Maryland Avenue SW, near 14th Street (luxury hotel).

Finances: $ 105 million project requires $ 33 million TIF bond to cover $ 25 million funding gap.

Status: Precertified by chief financial officer; on schedule for further approvals this year.